WRITTEN REMARKS OF BETTER MARKETS

For the

CFPB SYMPOSIUM ON COST-BENEFIT ANALYSIS IN CONSUMER FINANCIAL PROTECTION REGULATION

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In

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Submitted
By

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INTRODUCTION

My name is Stephen Hall and I serve as the Legal Director and Securities Specialist for Better Markets. We appreciate the opportunity to participate in this important symposium and we thank the CFPB for inviting us.

Better Markets is a non-profit, independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets. We fight for strong oversight, accountability, and transparency on Wall Street so that our financial system remains stable and investors and consumers are protected from fraud and abuse. Our ultimate goal is to help ensure that our financial system better serves the real economy and all Americans.

In our comment letters, amicus briefs, and special reports, we have fought long and hard against attempts by the financial services industry to nullify or weaken regulation by forcing agencies to engage in an exhaustive and quantitative cost-benefit analysis for each rule they promulgate.[1] In 2012, we issued a report examining the largely successful attempt to foist more stringent cost-benefit analysis requirements upon the SEC, even though the securities laws include no such mandate. We briefly updated the report in 2017, and that more recent examination of some of the key issues and cases involving cost-benefit analysis is attached to these remarks.

In our view, requiring agencies to conduct quantitative cost-benefit analysis in their rulemaking process does more harm than good. Cost-benefit analysis is inaccurate and biased; costly and burdensome; and often divorced from the type of economic analysis that Congress actually intended the agency to conduct under its organic statute. It also rests on the false premise, routinely advanced by the regulated industry, that regulation threatens to impose crushing burdens, ultimately harming consumers by eliminating supposedly valuable "choices" in the financial marketplace. In fact, these claims have consistently proven to be false throughout the history of financial regulation.

We are especially concerned about the drawbacks of cost-benefit analysis as applied at the CFPB. The agency has served for much of its history as an extraordinarily effective champion of consumer protection. Unfortunately, under the current Administration, the agency has

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[1] *See, e.g.,* BETTER MARKETS, SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC (July 30, 2012), https://bettermarkets.com/sites/default/files/Setting%20The%20Record%20Straight.pdf; Brief Amicus Curiae of Better Markets, Inc. in Support of Respondent at 15-25, *N.Y.S.E v. SEC*, No. 19-1042 (D.C. Cir. Aug. 1, 2019), https://bettermarkets.com/resources/court-filing-sec-attempts-protect-investors-and-market-integrity-exposing-exchange-pricing; Better Markets, Comment Letter to the FDIC on Request for Information on a Framework for Analyzing the Effects of Regulatory Actions (Jan. 28, 2020), available at https://bettermarkets.com/sites/default/files/Better_Markets_Comment_Letter_on_FDIC_Request_for_Information_on_a_Framework_for_Analyzing_the_Effects_of_FDIC_Regulatory_Actions_%28RIN_3064-ZA13%29.pdf.

strayed from its foundational mission, in both rulemaking and enforcement.[2] To the extent the CFPB embraces ever-more exhaustive and quantitative cost-benefit analysis, notwithstanding its limited duty under the law, its ability to effectively protect consumers from fraud and abuse will be further compromised. That may gratify payday lenders, student loan servicers, mortgage companies, and other financial institutions that often prey on consumers, but it will betray millions of everyday Americans who rely on the CFPB to protect them.

These concerns are fueled by the CFPB's recently finalized rule that rescinds the underwriting requirements for payday lenders, a rule that the agency put in place just two years ago after a long and thorough rulemaking process. That rulemaking stands as a stunning example of an agency betraying its core mission and catering to the regulated industry, justified largely through a distorted cost-benefit analysis.

Perhaps someday economists and social scientists will develop a methodology for cost-benefit analysis that is truly accurate, fair, efficient, and capable of effectively protecting the public interest without favoring the regulated industry. Many accomplished and dedicated academics are focused on the task, including those participating in this symposium. Needless to say, Better Markets is not optimistic about the odds of finding such a holy grail of cost-benefit analysis.

In any case, one thing is clear: We'll know that a genuinely fair and reliable approach to cost-benefit analysis has arrived when the financial services industry and its allies in the White House, on the Hill, and at times even within the regulatory agencies stop insisting that exhaustive cost-benefit analysis should be mandated for every rulemaking. Until that clamor ends, we can assume that cost-benefit analysis favors the de-regulatory agenda of the industry. It's much like the intense debate over mandatory arbitration: We'll know that arbitration is a truly fair and effective means of redress for investors when banks and brokerage firms no longer force it down investors' throats in fine print account agreements.

In these remarks, I'll briefly outline our core points about the weaknesses of cost-benefit analysis, its use as a weapon to thwart strong regulation in the public interest, and some principles that the CFPB and all agencies should observe as they evaluate the economic impact of their rules. I look forward to the panel discussion.

OUTLINE: A CRITIQUE OF COST-BENEFIT ANALSYIS

Overview. The application of quantitative cost-benefit analysis in the area of financial regulation does more harm than good:

[2] *See* Comment Letter from Better Markets to the CPPB on its Taskforce on Federal Consumer Financial Law (July 1, 2020) , available at https://bettermarkets.com/sites/default/files/Better_Markets_Comment_Letter_on_CFPB_Request_for_Information_to_Assist_the_Taskforce_on_Federal_Consumer_Financial_Law.pdf.

- It produces inaccurate and biased results.
- It drains agency resources.
- It slows the rulemaking process.
- It sets the stage for legal attacks on final rules.
- It rests on false notions that regulation unduly burdens the financial services industry and even harms consumers.
- It often conflicts with what Congress has actually said or intended in an agency's organic statute.

In short, we have not seen credible evidence that the drawbacks of exhaustive or quantitative cost-benefit analysis as applied to financial regulation are outweighed by its benefits.

Cost-benefit analysis is inaccurate and biased. Cost-benefit analysis is unworkable because it is inaccurate and biased against the public interest and in favor of the regulated industry.

- It relies heavily on predictions and assumptions about a complex array of variables.
- It tends to undervalue many unquantifiable benefits of regulation or omit them entirely from the calculation.
- It assumes the availability of complete and accurate data that frequently doesn't exist or is exclusively in the hands of the industry.
- It's biased because quantifying industry cost is far easier than quantifying all of the public benefits that follow from regulation. It can thus lead to the erroneous inference that the costs of a rule will outweigh its benefits and that the rule should be abandoned or diluted.
- Moreover, there isn't even a consensus about what constitutes a "benefit" or a "cost."

Cost-benefit analysis is costly and burdensome. Rather than promoting strong rules that protect the public, cost-benefit analysis tends to raise obstacles to effective rulemaking:

- It drains agency resources by mandating the laborious process of economic analysis by a phalanx of economists.
- It slows the rulemaking process through the extremely time-consuming analysis.
- It sets the stage for successful challenges in court due to its inherent imprecision.
- It fosters weaker rules that protect the public less effectively.

Cost-benefit analysis rests on a false premise. The superficial appeal of cost-benefit analysis is largely based on the false premise that regulation constantly threatens to overburden the financial services industry, stifle innovation, and even harm consumers by reducing their "choices." In fact, history has shown time and time again that such draconian claims are false.

For example, a century ago, when securities regulation first emerged at the state level, Wall Street railed against it as an "unwarranted" and "revolutionary" attack upon legitimate business that would cause nothing but harm.[3] However, in the years following this early appearance of financial regulation, banks and their profits grew handsomely.[4] Subsequently, when the federal securities laws were adopted, Wall Street staunchly opposed them, claiming they would slow economic recovery by impeding the capital formation process and discouraging the issuance of new securities. In fact, in the years after the enactment of the federal securities laws, the nation's securities markets flourished. The same pattern has been repeated with each new effort to strengthen financial regulation, including deposit insurance, the Glass-Steagall Act, mutual fund reform, and the national market initiatives of the mid-1970s.[5]

In fact, strong regulation has repeatedly created the environment in which our financial markets and our economy can thrive. Illustrating the point, following passage of the Dodd-Frank Act ten years ago, and the issuance of hundreds of implementing regulations, the financial services sector thrived, with banks seeing record revenues, profits, and bonuses while increasing capital levels and engaging in robust lending.[6] And those reforms have played a vital role in helping our financial system weather the economic turmoil sparked by the current pandemic. On the other hand, de-regulation has famously led to financial disaster, from the stock market crash of 1929 crash to the financial crisis of 2008.

Cost-benefit analysis often conflicts with the law. Cost-benefit analysis is often contrary to the law because it is not what Congress has actually required or intended in an agency's organic statute. For decades, the guiding principle was that Congress decides what level of economic analysis to require of an agency, and that duty could vary widely, including a

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3 *See* Marcus Baram, *The Bankers Who Cried Wolf: Wall Street's History of Hyperbole About Regulation*, THE HUFFINGTON POST (Jun. 21, 2011, 6:56 PM), available at http://www.huffingtonpost.com/2011/06/21/wall-street-historyhyperbole-regulation_n_881775.html.

4 Paul G. Mahoney, *The Origins of the Blue-Sky Laws: A Test of Competing Hypotheses*, 46 J.L. & ECON. 229, 249 (2003) ("In the 5 years following adoption of a merit review statute [the most stringent type of blue-sky law statute], bank profits increased on average by nearly 5 percentage points . . .").

5 Marcus Baram, *supra*; *see also* Nicholas Economides et al., *The Political Economy of Branching Restrictions and Deposit Insurance: A Model of Monopolistic Competition Among Small and Large Banks*, 39 J. L. & ECON. 667, 698 (1996) ("The American Bankers Association fights to the last-ditch deposit guarantee provisions of the Glass-Steagall Bill as unsound, unscientific, unjust and dangerous. Overwhelmingly, the opinion of experienced bankers is emphatically opposed to deposit guarantee which compels strong and well-managed banks to pay losses of the weak . . .The guarantee of bank deposits has been tried in a number of states and resulted invariably in confusion and disaster . . . and would drive the stronger banks from the Federal Reserve System.") (quoting Francis H. Sisson, president of the American Bankers Association).

6 *See* Better Markets, Special Report, *Ten Years of Dodd-Frank and Financial Reform; Obama's Successes, Trump's Rollbacks, and Future Challenges* (July 21, 2020), available at https://bettermarkets.com/sites/default/files/images/BetterMarkets_DoddFrankReport.pdf.

prohibition against conducting cost-benefit analysis, a simple duty to consider various factors in the rulemaking process, or a duty to conduct a robust, quantitative cost-benefit analysis.

As the Supreme Court made clear 40 years ago, an agency's duty to conduct cost-benefit analysis is not to be inferred without a clear indication from Congress: "Congress uses specific language when intending that an agency engage in cost-benefit analysis."[7]

The Supreme Court has also made clear that the duty to "consider" various economic factors in the rulemaking process entails wide agency discretion. As the Court explained, when statutorily mandated "considerations" are not "mechanical or self-defining standards," they "in turn imply wide areas of judgment and therefore of discretion."[8]

Unfortunately, these statutory mandates have increasingly lost their sway. This gap has grown over the years as a result of flawed court decisions, industry lobbying, and political pressure from anti-regulatory policymakers in the White House, on the Hill, and even within the agencies. For example, some of the leading cases on cost-benefit analysis from the D.C. Circuit represent horrendous examples of courts departing from the statutory language and legislative intent embodied in an agency's organic statute. The *Chamber of Commerce* and *Business Roundtable* cases that invalidated SEC rules exemplify this phenomenon.

Nevertheless, some more recent D.C. Circuit decisions have reinforced the traditional canons of cost-benefit analysis. For example, in *Nat'l Ass'n of Mfrs. v. SEC*, the D.C. Circuit upheld the SEC's economic analysis for its rule requiring public companies to track the origin of, and disclose information about, the conflicts minerals they use. The court wrote that the law did not mandate rigorous, quantitative analysis: "An agency is not required to measure the immeasurable, and need not conduct a rigorous, quantitative economic analysis unless the statute explicitly directs it to do so." The court identified two additional reasons why agencies like the CFTC and the SEC cannot be expected to perform cost-benefit analysis: It forces them to make an "apples-to-bricks" comparison whenever intangible benefits—such as peace and security—cannot be framed in terms of dollars and cents, and it forces them to second-guess the judgments that Congress has already made about the costs and benefits of regulation.

While the Supreme Court's decision in *Michigan v. EPA*[9] represents a significant move in the direction of cost-benefit analysis, the decision did not upend the core precedents and principles previously laid down. The decision was poorly reasoned, the outcome was closely tied to the statutory context of environmental law, and the opinion expressly reinforced the rule that quantitative cost-benefit analysis requires a clear directive from Congress, as well as the rule that the duty to "consider" economic factors is far different from cost-benefit analysis and vests wide discretion in the agency.

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7 *Am. Textile Mfrs. Inst., Inc. v. Donovan*, 452 U.S. 490, 510-512 & n. 30 (1981).

8 *Sec'y of Agriculture v. Cent. Roig Refining Co.*, 338 U.S. 604, 611-12 (1950).

9 *Michigan v. Envtl. Prot. Agency*, 135 S. Ct. 2699 (2015).

<u>Cost-benefit analysis has been widely deployed as a de-regulatory weapon.</u> Cost-benefit analysis has a long history of use by industry as a weapon to defeat regulation. Through court challenges, executive orders, and attempts to pass innumerable bills in Congress, the financial services industry has fought to entrench rigorous and quantitative cost-benefit analysis at all federal agencies so it can use the record of that analysis to upend rules in court if they are not satisfied with the agency's final product. Throughout this campaign, they have exploited the intuitive yet deceptive appeal of cost-benefit analysis, which can be portrayed as sensible, reliable, and precise methodology that enables policymakers to fashion ideal regulatory solutions by objectively quantifying and weighing different options.

NOTES ON COST-BENEFIT ANALYSIS AT THE CFPB

The CFPB's core duty under Section 1022 of the Dodd-Frank Act is to "consider" the "potential benefits and costs" to consumers and covered persons from a rule, as well as the potential reduction in consumer access to financial products and services and the impact on covered persons. In accordance with Supreme Court precedent, that imposes no duty to quantify or net costs and benefits.

While the Bureau appropriately recognizes that it is not required to tabulate costs and benefits, net them against each other, or find that benefits exceed costs, it nevertheless has adopted a more aggressive approach to cost-benefit analysis, adopting the methodologies actually intended for the executive branch agencies set forth in executive orders and OIRA guidance, including the quantification of costs and benefits.

The CFPB's own recently finalized rule rescinding the 2017 underwriting requirements for payday lenders illustrates some of the profound problems with cost-benefit analysis.[10] The rule is indefensible on multiple levels, including the harmful impact it will have on countless desperate consumers who will become trapped in the endless cycles of debt and fee payments so profitable for the industry. But its approach to cost-benefit analysis is especially striking.

The original rule, issued in 2017,[11] resulted from an extraordinarily thorough rulemaking process, involving five years of work and analysis, including field hearings, new research by the CFPB, a review of innumerable academic studies, and the consideration of over a million comment letters. The rule made it an unfair and abusive practice to extend payday and vehicle title loans without determining that consumers have the ability to repay the loans according to their terms.

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10 CFPB, Payday, Vehicle Title, and Certain High-Cost Installment Loans, Final Rule, RIN 3170-AA80 (July 7, 2020); Comment Letter of Better Markets to CFPB on the Proposed Rescission of the Underwriting Requirements (May 15, 2019), available at https://bettermarkets.com/sites/default/files/Better%20Markets%20CL%20CFPB%20Payday%20Underwriting%20Rescission%205-15-2019_0.pdf.

11 CFPB, Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54472 (Nov. 17, 2017).

Earlier this month, the CFPB rescinded that requirement on a number of grounds, none of which were persuasive. Among them was the contention that the CFPB had previously undervalued the benefits of payday loans to consumers and to competition. Moreover, in the Section 1022 analysis, the release identified the primary benefits of rescinding the underwriting requirements as increasing or preserving access to payday loans for consumers, as well as ensuring robust revenues, loan volumes, and storefronts for the payday lending industry.

A number of conclusions follow. If the original cost-benefit analysis in the 2017 rule was indeed wrong, after such an exceptionally thorough rulemaking process spanning five years, then the methodology of cost-benefit analysis must be hopelessly unwieldy and unreliable. If, on the other hand, the original rulemaking was sound, then we know that even the best cost-benefit analysis has little value, as it can always be upended, second-guessed, or manipulated by agency leadership to change the outcome—this time as an accommodation to a notoriously abusive regulated industry.

PRINCIPLES THAT SHOULD GUIDE ECONOMIC ANALYSIS AT THE CFPB AND OTHER FINANCIAL REGULATORS

- Follow the law and what Congress has actually required of the agency in its organic statute.

- Do not undertake more cost-benefit analysis than is necessary, as the D.C. Circuit has repeatedly held that if an agency undertakes a cost-benefit analysis even though it is not required to do so, the court will still evaluate the adequacy of that analysis and strike the rule down if it falls short in the court's eyes.[12]

- Where the mandate is to "consider" costs and benefits, as it is at the CFPB, the agency need not undertake quantitative cost-benefit analysis.

- If a rule is mandatory, highlight the significance of this fact and point out that Congress has already made judgments about the costs and benefits of the rulemaking.

- If required to conduct quantitative cost-benefit analysis, put the quantitative cost figures in context. For example, compare industry compliance costs with the industry's revenues, profits, and pay scales.

- Highlight and give due weight to all of the benefits of regulation, direct and indirect and tangible and intangible. They include preventing the human suffering that comes with financial fraud and financial loss; maintaining a stable financial system that is less prone to crises that can impose enormous societal costs in the trillions of dollars; and bolstering the integrity of our markets and the confidence that helps them thrive.

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12 *Am. Equity Inv. Life Ins. Co. v. Sec. & Exch. Comm'n.*, 613 F.3d 166, 168 (D.C. Cir. 2010).

- Evaluate the benefits of a rule as a component of a larger framework that confers larger benefits. This is especially important when it comes to prudential regulation focused on the stability of institutions and markets. But it is also true of consumer regulation, in part because widespread abuses can lay the foundation for a devastating market crisis, just as mortgage-lending fraud and abuse provided the fodder for the 2008 crisis.

- Closely scrutinize, test, and discount sky-is-falling claims from the regulated industry that restrictions on profitable activities, or the imposition of compliance costs, will overburden the industry and ultimately hurt consumers by depriving them of choices in financial products and services.

- Discount industry-sponsored studies, and before relying on supposedly independent research, determine and disclose who requested, sponsored, and funded those studies.

- Recognize that even where a regulatory prohibition or affirmative requirement might in fact narrow certain choices in the financial marketplace, the impact on investors is still likely to be beneficial, as toxic and abusive products and services almost invariably inflict harm on consumers. Moreover, exceedingly few consumers have the knowledge or sophistication to navigate such choices or knowingly and intentionally assume their risks. This is not paternalistic; rather, it reflects the well-established principle that everyone in society benefits when guardrails are established for industry, from food safety, environmental protection, and seatbelt use to financial regulation that prevents fraud, abuse, and reckless financial conduct.

UPDATE: RECENT TRENDS IN THE LAW GOVERNING COST-BENEFIT ANALYSIS BY THE SECURITIES AND EXCHANGE COMMISSION

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Better Markets, Inc.

INTRODUCTION

Decades ago, the United States Supreme Court and the lower federal courts established the basic principles governing judicial review of agency rulemaking under the Administrative Procedure Act. Those decisions repeatedly held that courts generally owe a high level of deference to agency expertise and judgment. And with respect to economic analysis, those precedents also held that courts must adhere to the actual requirements that Congress has imposed on an agency under its "organic statute," whether it be (1) detailed cost-benefit analysis; (2) something more limited, such as the duty merely to consider certain economic factors; or (3) in some cases, language prohibiting an agency from allowing the costs and benefits of regulation to influence the way an agency crafts its rules.

Unfortunately, from 2005 to 2011, the D.C. Circuit issued a series of opinions striking down several SEC rules based largely on what the court perceived as deficiencies in the SEC's economic analysis for each rule. In reality, as discussed below, those opinions ignored or misread the actual text of the securities laws, the precedents limiting the scope of an agency's duty simply to "consider" certain factors, and well-established principles of judicial deference to agency judgment. The court went so far as to impose a far-reaching duty on the SEC to determine the economic consequences of its rules, to quantify costs and benefits, and to assess whether a rule would confer a "net benefit."

These cases ushered in a new era at the SEC, prompting it to undertake increasingly extensive cost-benefit analyses in its rulemakings, even though the securities laws impose no such requirement. This approach has taken a toll on the SEC's rulemaking output. The agency has spent a huge portion of its budget expanding its pool of economists; the pace of its rulemaking has slowed; and some final rules appear to reflect the weaknesses born, at least in part, of concern that rules will be challenged in court.

In 2012, Better Markets issued a report highlighting the financial industry's use of cost-benefit analysis to weaken and impede regulation in general and at the SEC in particular, detailing the legal and policy arguments against cost-benefit analysis and calling upon the SEC to change its approach.[13] Now, five years later, we revisit these issues and renew our call for resistance to attempts by industry advocates, policymakers, and some courts to require federal regulatory agencies to conduct exhaustive cost-benefit analysis of each rule they promulgate. Within the last few years, panels of the D.C. Circuit, along with some district court judges, have signaled a welcome return to the basic canons of deference to agency judgment and fidelity to legislative text when deciding whether an agency rule should be upheld against an attack on its economic analysis. While the Supreme Court's flawed 2015 decision in *Michigan v. EPA* signals a broader embrace of cost-benefit analysis in the rulemaking process, it does not represent the end of this debate in the courts or elsewhere.

In the following sections of this update, we briefly review some of the basic truths about the flaws in cost-benefit analysis, and we canvass some of the most important recent developments in this area of financial regulation, highlighting these points:

- Cost-benefit analysis is an inherently appealing notion at first blush, but in reality, it represents an unreliable, biased, counterproductive, and even dangerous threat to the financial regulations we need to protect the stability of our financial system, prevent another crisis, and contain the fraud and abuse that continue to victimize investors and consumers.

- On the Hill, attempts to impose exhaustive cost-benefit analysis requirements on all regulatory agencies have continued unabated since the passage of the Dodd-Frank Act. So far, fortunately, they have largely failed.

- In the courts, recent decisions reflect for the most part a welcome return to core principles, including, for example, that agencies are not required to perform quantitative cost-benefit analysis unless Congress has clearly and expressly said so—something Congress it has not done with respect to the financial regulators, including the SEC.

- In the Administration, while President Trump has issued numerous executive orders and memoranda aimed at tearing down valuable financial regulations, the basic principle articulated in prior executive orders on cost-benefit analysis (including notably E.O. 12866) remains intact: The independent regulatory agencies are not subject to the cost-benefit analysis requirements set forth in those orders.

- Although the trend among academics is not uniform, a number of prominent thinkers continue to argue persuasively that cost-benefit analysis cannot reasonably be applied to financial regulation.

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[13] BETTER MARKETS, SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC (July 30, 2012), *available at* https://bettermarkets.com/sites/default/files/Setting%20The%20Record%20Straight.pdf.

ANALYSIS

I. Why cost-benefit analysis is such an appealing weapon for those in industry who seek to delay, weaken, or strike down financial regulation.

Insisting on the application of rigid, quantitative cost-benefit analysis requirements to proposed financial regulations has proven to be an effective tactic that Wall Street and its allies use in their unremitting fight against financial reform. This tactic owes some of its success to the fact that "cost-benefit analysis" sounds like the type of exercise that no thoughtful person would oppose. The very phrase has an inherent appeal, as it connotes rigorous comparative scrutiny grounded in precise economic calculations, supposedly all in the quest for sound regulatory policy.

In fact, the opposite is closer to the truth. The costs and benefits of proposed financial regulations are inherently resistant to accurate quantification and numerical comparative evaluation. Attempting to subject such regulations to rigid, quantitative cost-benefit analysis suffers from multiple problems, as explained below, which undermine rather than promote the public interest.

At best, quantitative cost-benefit analysis of financial regulation is intrinsically biased against the public interest and in favor of leniency toward regulated industries. And it is highly assumption-sensitive, dependent on speculation and the exercise of immense discretion, and ultimately imprecise and unreliable. At worst, quantitative cost-benefit analysis requirements serve as a Trojan Horse for Wall Street and its allies to wage war against regulation under the guise of advocating for objective economic analysis. Indeed, opponents of financial reform have chosen this front on which to wage battle precisely because "cost-benefit analysis" sounds like a neutral and unobjectionable instrument for developing public policy.

II. Why cost-benefit analysis is so unreliable and potentially harmful.

Cost-benefit analysis is flawed for multiple reasons. In summary:

- Cost-benefit analysis is inherently unreliable, as it depends on imprecise assumptions, predictions, and quantifications that are extremely difficult to make with accuracy. One of the most challenging variables in the exercise is trying to predict how the industry will react and adapt to a rule. That difficult assessment largely determines how costly a rule will prove to be for industry and how effective it will prove to be in conferring benefits on financial markets and investors.

- Compounding the problem, reliable data on which to base cost-benefit analysis is often accessible only to the regulated firms and not to the agency attempting to promulgate a rule. Moreover, when the regulated firms do decide to share their data with regulators, they often do so selectively, thus undermining the accuracy of any resulting analysis and skewing it in favor of the industry's perspective.

- Cost-benefit analysis is inherently biased in favor of the regulated industry, since costs of compliance and other costs borne by the industry are generally much easier to quantify in dollar terms than the benefits of regulations, which have a comparatively larger non-monetary component. For example, a rule that aims to reduce fraud and manipulation in the securities markets promises cascading benefits, well beyond preventing just the monetary losses arising from fraud. These other benefits include greater investor confidence, leading to more robust financial markets, greater economic growth, and overall prosperity. In addition, preventing fraud and abuse confers incalculable benefits in terms of reducing the human anguish that comes with victimization and financial loss.

- Cost-benefit analysis is myopically focused on the costs and benefits of individual rules, typically ignoring the need to assess the value of rules holistically, each one serving as part of a collection of rules that work together in preventing extremely damaging and large-scale disruptions and failures in the financial markets. The financial crisis of 2008 will ultimately cost $20 trillion in lost economic productivity, not to mention the enormous human suffering it spawned.[14] Many financial regulations are instrumental in helping to prevent such crises, yet that aspect of their value is routinely ignored or underweighted.[15]

- Cost-benefit analysis is extremely time-consuming and costly, draining off scarce agency resources and protracting the rule-making process. A prime example is the SEC's decision some years ago to vastly expand the pool of economists on staff, in an attempt to produce more accurate cost-benefit analysis, at great expense to the agency.

- Cost-benefit analysis can put an agency in the untenable position of second-guessing value judgments that Congress has already made, especially if the rulemaking process is mandatory, not discretionary.

- Cost-benefit analysis makes rules more vulnerable to successful legal challenge in court. This is evident from the now-routine and often successful use of cost-benefit analysis as

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[14] *See, e.g.*, BETTER MARKETS, THE COST OF THE CRISIS - $20 TRILLION AND COUNTING (July 2015), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis-2.pdf.

[15] The Financial Stability Oversight Counsel under the prior Administration exemplified this holistic view of regulatory impact when it exercised its recommendation authority and pressed the SEC to adopt stronger reforms governing money market funds. Section 120 of the Dodd-Frank Act required the FSOC to consider the impact of the proposed recommendation on long-term economic growth. The FSOC did so in part by pointing out that because financial crises have such a profoundly damaging impact on economic activity and economic growth over an extended period, "reforms that even modestly reduce the probability or severity of a financial crisis would have considerable benefits in terms of greater expected economic activity and, therefore, higher expected economic growth." Proposed Recommendations Regarding Money Market Mutual Fund Reform, 77 Fed. Reg. 69,455; 69,481-82 (Nov. 19, 2012).

the basis on which to attack rules in court. Those court challenges not only threaten to invalidate important rules, they also further consume agency resources in the litigation process.

- Finally, cost-benefit analysis is dilutive, since the threat of legal challenge induces regulators to compromise or weaken the provisions of a given rule, not because those alterations will better serve the public interest, but because they may make the rule less likely to draw a successful court challenge.

III. The constant stream of legislative proposals to impose more onerous cost-benefit analysis requirements on agencies, particularly the independent agencies.

Since the Dodd-Frank Act was signed into law in July of 2010, a steady stream of legislative proposals has emerged that would impose burdensome new cost-benefit analysis requirements on the SEC and other independent agencies. The timing of these bills was hardly coincidental, coming on the heels of the Dodd-Frank Act, which required financial regulatory agencies to produce hundreds of new rules. Included among those proposals were these:

- Congressional Office of Regulatory Analysis Creation and Sunset and Review Act of 2011[16]
- SEC Regulatory Accountability Act (2012)[17]
- SEC Regulatory Accountability Act (2013) (re-proposed)[18]
- Independent Agency Regulatory Analysis Act (2013)[19]
- Regulatory Sunset and Review Act of 2013[20]
- Unfunded Mandates Information and Transparency Act of 2014[21]

For example, the SEC Regulatory Accountability Act would require the agency to conduct a searching, quantitative cost-benefit analysis for every new rule. It would also mandate that the SEC identify every "available alternative" to a proposed agency action.[22] Given that "available alternatives" to any proposed action abound, this requirement would impose a crushing analytical burden on the agency.[23] The Act also would require several other new assessments of the effects of a rule on liquidity, investor choice, "market participants," state and local

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16 H.R. 214, 112th Cong. (2011).
17 S. 3468, 112th Cong. (2012).
18 H.R. 1062, 113th Cong. (2013).
19 S. 1173 113th Cong. (2013).
20 H.R. 309, 113th Cong. (2013).
21 H.R. 899, 113th Cong. (2014).
22 *Id.* at § 2.
23 *Id.*

governments, and small businesses—all of which effectively command the SEC to consider the costs of regulation without a corresponding analysis of the benefits.[24] Further, any questions concerning the SEC's compliance with these new analytical requirements would render new rules more vulnerable to legal challenge.

An even more draconian set of cost-benefit analysis burdens has been proposed in Title III of the CHOICE Act 2.0, which passed the House on June 8, 2017.[25] Just a sampling of its provisions includes these requirements in the rulemaking process:

- An extraordinarily long list of newly required analytical steps, such as an identification of the need for the rule; an explanation as to why state, local, or tribal governments should not handle the problem; an analysis of the adverse impact on regulated entities, all market participants, and the economy; a quantitative and qualitative assessment of all anticipated costs and benefits of the rule; an evaluation of the costs to state, local, or tribal governments; an identification of available alternatives to the regulation; an explanation of how the burden of regulation will be distributed among market participants; an assessment of the extent to which the regulation is inconsistent, incompatible, or duplicative with existing regulations; a description of any studies, surveys, or other data relied upon in preparing the analysis; and a prediction of changes in market structure, infrastructure, and the behavior of market participants in response to the rule;[26]

- Retrospective review of all rules within one year and every five years thereafter, followed by mandatory reports on ways to simplify rules;[27]

- Expanded opportunities for challenging rules in court by any affected person;[28]

- Congressional approval for all major rules; [29] and

- De novo judicial review of all questions of law raised in a rule challenge, thus eliminating the long-standing *Chevron* doctrine that requires courts to defer to agency judgments where they are interpreting a statutory provision with some degree of ambiguity.[30]

Any agency subject to these impossibly burdensome requirements would be virtually unable to promulgate new rules, and any rules that did emerge from an agency would be easy targets for successful challenge in court. That of course, is the anti-regulatory intent behind these

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24 *Id.*
25 H.R. 10, 115th Cong. (2017).
26 *Id.* at § 312.
27 *Id.* at § 315.
28 *Id.* at § 317.
29 *Id.* at § 332.
30 *Id.* at § 341.

and similar statutory provisions. Fortunately, to date, these suffocating new rulemaking requirements have not emerged from Congress.

IV. Trends in the courts.

Allegations that an agency failed to conduct an adequate cost-benefit analysis are now a staple of court challenges to financial regulations. The push in the courts for judicially enforceable, quantitative cost-benefit analysis has been effective in many instances. The anti-regulation movement reached a high point with the D.C. Circuit's opinion in *Business Roundtable v. SEC*,[31] striking down the SEC's proposed proxy access rule. Another more recently successful deployment of cost-benefit analysis appeared last year's decision in *Metlife v. Financial Stability Oversight Council*.[32] These and a few other important cases are discussed below.

A. Earlier decisions where courts used cost-benefit analysis to strike down rules

Starting in the early- to mid-2000s, financial trade organizations initiated an aggressive series of rule challenges in court under the Administrative Procedure Act and applicable "organic statutes." One of the most significant early wins came in a 2005 case where the Chamber of Commerce sued the SEC to challenge its rule designed to promote better corporate governance in mutual funds.[33] There the D.C. Circuit held that the narrow statutory duty to consider whether a rule will promote efficiency, competition, and capital formation actually calls upon the SEC to conduct a much broader analysis and to "determine as best it can the economic implications of the rule."[34] The court ruled that the SEC's failure to quantify and analyze the costs of the conditions it was imposing under the rule ran afoul of this obligation. In effect, the court read statutory language commanding an agency to consider a rule's potential effects on a limited number of discrete factors to mean that the agency was required to perform a broad cost-benefit analysis of the rule.

In the years following *Chamber of Commerce*, the D.C. Circuit continued to strike down major financial rules, in some cases relying explicitly on the agency's alleged failure to conduct an adequate cost-benefit analysis. For example, in *American Equity*, the D.C. Circuit vacated an SEC rule providing that fixed indexed annuities were not exempt from securities regulation, concluding that the SEC's consideration of the effect of the proposed rule on efficiency, competition, and capital formation was insufficient.[35]

Challenges to financial regulatory authority and well-established principles of judicial deference to the expert judgment of regulators arguably reached their peak in the 2011 case *Business Roundtable v. SEC.* The D.C. Circuit struck down a proposed rule requiring companies to provide information about, and the right to vote for, board nominees chosen by large shareholders rather than just those board nominees chosen by an incumbent board of directors.

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31 647 F.3d 1144 (D.C. Cir. 2011).

32 177 F. Supp. 3d 219 (D.D.C. 2016).

33 *See Chamber of Commerce v. Sec. & Exch. Comm'n.*, 412 F.3d 133 (D.C. Cir. 2005).

34 *See id.* at 143.

35 *Am. Equity Inv. Life Ins. Co. v. Sec. & Exch. Comm'n.*, 613 F.3d 166, 168 (D.C. Cir. 2010).

Although the SEC included a detailed cost-benefit analysis in its proposed rule, the D.C. Circuit nonetheless vacated the rule "for having failed once again . . . adequately to assess the economic effects of a new rule."[36]

The court explained that the SEC had "relied upon insufficient empirical data," and it took issue with—and supplanted—the SEC's judgments regarding various studies on the issues presented. The court faulted the SEC for relying "heavily upon two relatively unpersuasive studies" and, without explaining why the SEC's favored studies deserved less weight, found that the SEC had "not sufficiently supported its conclusion."[37] In effect, the court dismissed a lengthy economic analysis and detailed consideration of opposing studies simply as inadequate. And in so doing, the court substituted its own inexpert judgment for the expert analysis of the agency, in contravention of long-established principles of administrative law.[38]

The misreading of the securities laws reflected in this series of decisions from the D.C. Circuit contravened a rich vein of precedent on cost-benefit analysis, not to mention broader, black-letter principles of deference to administrative agencies. For example, as far back as 1950, the Supreme Court held that the duty to "consider" factors—just as the securities laws narrowly provide with respect to efficiency, competition, and capital formation—confers wide discretion on an agency: When statutorily mandated "considerations" are not "mechanical or self-defining standards," they "in turn imply wide areas of judgment and therefore of discretion."[39]

In addition, decades ago, the Supreme Court held that an agency's duty to conduct cost-benefit analysis is not to be inferred without a clear indication from Congress: "Congress uses specific language when intending that an agency engage in cost-benefit analysis."[40] And one of the basic canons of judicial review of agency rules is that "the scope of review under the arbitrary and capricious standard is narrow and a court is not to substitute its judgment for that of an agency."[41] This is "especially true when the agency is called upon to weigh the costs and benefits of alternative policies,"[42] and in fact, "cost-benefit analyses epitomize the types of decisions that are most appropriately entrusted to the expertise of an agency."[43] Fortunately, as explained below, some more recent decisions reflect a return to these principles.

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36 *Business Roundtable v. Sec. & Exch. Comm'n.*, 647 F.3d at 1148.

37 *Id.* at 1151.

38 *See* *James D. Cox and Benjamin J.C. Baucom, *The Emperor Has No Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority*, 90 TEXAS LAW REVIEW 1811 (2012). Available at: https://scholarship.law.duke.edu/faculty_scholarship/2529/.

39 *Sec'y of Agriculture v. Cent. Roig Refining Co.*, 338 U.S. 604, 611-12 (1950).

40 *Am. Textile Mfrs. Inst., Inc. v. Donovan*, 452 U.S. 490, 510-512 & n. 30 (1981).

41 *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983).

42 *Consumer Elecs. Ass'n v. FCC*, 347 F.3d 291, 303 (D.C. Cir. 2003).

43 *Office of Commc'n of United Church of Christ v. FCC*, 707 F.2d 1413, 1440 (D.C.Cir.1983).

B. The judicial movement away from strict cost-benefit analysis.

In two major cases since the *Business Roundtable* decision, the D.C. Circuit has upheld significant financial regulations of the Commodity Futures Trading Commissions (CFTC) and the SEC against challenges from the Investment Company Institute and the National Association of Manufacturers that were predicated largely on allegedly deficient cost-benefit analyses.[44]

In *Investment Company Institute v. CFTC*,[45] the D.C. Circuit upheld the CFTC's economic analysis for its rule requiring SEC-registered investment companies engaged in significant derivatives trading to also register as commodity pool operators. The court acknowledged that the relevant statutory standard does not require rigorous, quantitative analysis: "Where Congress has required 'rigorous, quantitative economic analysis,' it has made that requirement clear in the agency's statute, but it imposed no such requirement [in the Commodity Exchange Act]."[46] The court further found that the agency had been faithful to the text of the Commodity Exchange Act, which requires only that the CFTC "consider" costs and benefits in light of certain factors. Summing up, the court added that "the law does not require agencies to measure the immeasurable."

In *Nat'l Ass'n of Mfrs. v. SEC*,[47] the D.C. Circuit upheld the SEC's economic analysis for its rule requiring public companies to track the origin of, and disclose information about, the conflicts minerals they use. The court wrote that the statutory test does not mandates rigorous, quantitative analysis: "An agency is not required to measure the immeasurable, and need not conduct a rigorous, quantitative economic analysis unless the statute explicitly directs it to do so." The court identified two additional reasons why agencies like the CFTC and the SEC cannot be expected to perform cost-benefit analysis: It forces them to make an "apples-to-bricks" comparison whenever intangible benefits—such as peace and security—cannot be framed in terms of dollars and cents, and it forces them to second-guess the judgments that Congress has already made about the costs and benefits of regulation.

C. Three recent cases.

Three recent decisions, one from the Supreme Court, one from the D.C. Circuit, and one from the D.C. district court, show that the judicial approach to cost-benefit analysis remains unpredictable. None of those decisions alter the recent and positive holdings from the D.C. Circuit in *ICI* and *NAM*, to the effect that agencies are not under an obligation to conduct quantitative cost-benefit analysis unless Congress clearly imposes that requirement. Nor do they alter the other core principle established 50 years ago that the duty to "consider" statutorily enumerated factors vests broad discretion in the agency as to how to evaluate those factors and

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44 *Inv. Co. Inst. v. U.S. Commodity Futures Trading Comm'n*, 891 F. Supp. 2d 162, 202 (D.D.C. 2012), as amended (Jan. 2, 2013), aff'd sub nom. *Inv. Co. Inst. v. Commodity Futures Trading Comm'n*, 720 F. 3d 370 (D.C. Cir. 2013); *Nat'l Ass'n of Mfrs. v Sec. & Exch. Comm'n.*, 748 F. 3d 359 (D.C. Cir. 2014).

45 *Inv. Co. Inst. v. U.S. Commodity Futures Trading Comm'n*, 720 F. 3d 370 (D.C. Cir. 2013).

46 *Id.* at 379.

47 748 F. 3d at 370.

what weight to give them. Clearly, though, the Supreme Court's ruling in the *Michigan* case has already inspired at least one federal district court judge to take an extreme position in the *MetLife* case. And *Lindeen* signifies something of a middle ground in the jurisprudence surrounding cost-benefit analysis at the SEC, still embracing the idea that the agency must go beyond the statutory language and consider costs and benefits, but may do so without an empirically-based, quantitative analysis.

1. *Michigan v. EPA*

In *Michigan*, the Supreme Court reached the expansive conclusion that the EPA was required to consider costs when determining whether regulation of power plant emissions was "appropriate and necessary" under the Clean Air Act (42 U.S.C. § 7412(n)(1)(A) (2012)).[48] The Court also seemed call for something akin to a "net benefit" test by observing that "[n]o regulation is 'appropriate' if it does significantly more harm than good." The legal analysis underlying Justice Scalia's opinion was exceptionally weak, based largely on his own intuitive sense what the term "appropriate" must mean—even though "cost" has no place in the definition of the term—and without citation to legal authority for his core holding.

While the case may portend a major expansion in the Supreme Court's views about regulatory cost-benefit analysis, it is also limited in certain respects. The holding was highly contextual, the Court observing that "[t]here are undoubtedly settings in which the phrase 'appropriate and necessary' does not encompass costs."[49] A number of factors led to the Court's decision. For example, the EPA was operating in the context of numerous environmental statutory provisions and mandated studies that were heavily focused on cost assessments. In addition, the EPA was dealing with a specific mandate to determine whether to regulate at all, a point that figured prominently in the Court's decision: "Agencies have long treated cost as a centrally relevant factor when deciding whether to regulate."[50] In contrast, the SEC is typically wrestling with how to regulate, not whether it should do so in the first instance. Finally, even Justice Scalia at least recognized that the EPA's duty to "consider" cost did not require a "formal cost-benefit analysis in which each advantage and disadvantage is assigned a monetary value," as he declared that it would be "up to" the EPA to decide how to account for cost."[51]

2. *Metlife v. FSOC*

The holding in *Michigan* has inspired at least one district court judge to go to extraordinary lengths to impose a cost-benefit analysis duty where the applicable statute plainly does not require one.[52] In December of 2014, after almost two years of careful analysis, the Financial Stability Oversight Council (FSOC) exercised its authority under Section 113 of the Dodd-Frank Act to designate the massive global insurance company MetLife as a systemically important nonbank financial company, which would subject it to enhanced supervision by the Federal

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48 *Michigan v. Envtl. Prot. Agency*, 135 S. Ct. 2699 (2015).

49 *Id.* at 2707.

50 *Id.* (emphasis added).

51 *Michigan,* 135 S. Ct. at 2711.

52 *See MetLife, Inc. v. Financial Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016).

Reserve. The purpose of the designation was to mitigate the risk that MetLife could cause or contribute to another devastating financial crisis like the one that engulfed the nation in 2008.

MetLife challenged FSOC's designation in the D.C. federal district court, and on March 30, 2016, Judge Rosemary Collyer rescinded it, concluding that FSOC's designation was arbitrary and capricious, in part because the FSOC failed to consider of the cost of designation on MetLife.[53] In so doing, Judge Collyer misinterpreted both the Dodd-Frank Act and the Supreme Court's decision in *Michigan v. Environmental Protection Agency*, 135 S. Ct. 2699 (2015).

The court acknowledged that the Dodd-Frank Act nowhere expressly required the FSOC to conduct a cost-benefit analysis, and it further acknowledged that Congress clearly **had** imposed that requirement on agencies in other contexts. In reality, Section 113 of DFA requires the FSOC only to "consider" 10 listed factors when designating nonbank financial companies, and none of them includes any references to the cost or benefits of designation. And the last catchall factor simply grants the FSOC broad discretion to consider "any other risk-related factors that the Council deems appropriate."[54]

The court side-stepped all of these facts, however, with a tortured chain of reasoning based primarily on the Supreme Court's holding in *Michigan*. Keying off this decision, the district court in *MetLife* held that the FSOC's purely discretionary authority to consider other "risk-related factors that the Council deems **appropriate**" required it to consider the cost of designation to MetLife. To reach that implausible result, the court was left to reason that cost is a "risk-related factor" insofar as the costs of regulation imposed on an institution could make it more likely to experience financial distress in the first instance—a determination that the FSOC is not actually required to make at any point in the designation process.

The district court thus committed numerous errors in its decision, among others:

- It stretched the Supreme Court's holding in *Michigan* far beyond its narrow boundaries;
- It ignored the D.C. Circuit's holdings in *ICI* and *NAM;*
- It dismissed the plain meaning and intent of the last catchall factor in Section 113 ("other risk-related factors") (emphasis added), which has nothing to do with costs and benefits, either on its face or in context;
- It ignored the purely discretionary nature of the FSOC's authority to consider any other risk-related factors it "deems appropriate" (emphasis added); and

53 *See* Better Markets, "Fact Sheet on the MetLife v. FSOC Decision" (Apr. 15, 2016), *available at* https://bettermarkets.com/sites/default/files/MetLife%20Decision%20Fact%20Sheet%204-15-16%20Final.pdf.

54 12 U.S.C. § 5323(a)(2) (2012).

- It rested on the erroneous premise (of its own making elsewhere in its opinion) that the FSOC must assess the likelihood that an institution might someday experience financial distress—a proposition that finds no support in the law.

In its brief on appeal to the D.C. Circuit, the FSOC itself appropriately stressed the flawed logic in reading the 10 factors (especially the catchall factor) in Section 113 as even suggesting a nexus to cost-benefit analysis:

> In any event, the interpretation of "risk-related factor" adopted by the district court is untenable. The cost of complying with regulation bears no resemblance to any of the ten statutory factors that guide a designation decision. Those factors reflect Congress's determination that designation is proper when a financial company's material financial distress could threaten the stability of the U.S. financial system. **Keenly aware of the costs of inadequate regulation, Congress determined that the benefits outweigh the potential cost of regulations that are designed to improve the safety and soundness of the designated company as well as the stability of the financial system.**[55]

These, and other significant errors by the court cried out for appellate reversal. Extensive appellate briefing on the merits followed, including numerous amicus briefs from Better Markets and others arrayed on both sides of the important issues presented,[56] culminating in oral argument on October 24, 2016. However, the case lay dormant through the 2016 election, and beginning in April 2017, the Trump administration, embarked on what appeared to be a carefully choreographed plan, presumably in coordination with MetLife and its attorneys, to derail the appeal and prevent it from ever being decided on the merits by the D.C. Circuit. President Trump issued a memorandum on April 21, 2017 directing the Treasury Secretary to review FSOC's designation process and provide a report within 180 days. The factors the memorandum directed the Secretary to consider echoed the district court's opinion and the arguments MetLife advanced in its briefs. The D.C. Circuit held the case in abeyance pending release of the report. When the report was released, paving the way for the appeal to go forward, MetLife argued in supplemental briefing that the report supported MetLife's arguments, and FSOC, rather than opposing MetLife's brief, joined with MetLife in a motion requesting the appeal be dismissed, which the D.C. Circuit granted in January of 2018.

As a result, the district court's flawed opinion stands as a lasting interpretation requiring FSCO to conduct a cost-benefit analysis as a condition of designation. FSOC's ability to protect our economy from crisis has been severely damaged and the likelihood of future taxpayer

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55 Brief of Appellant at 54, *MetLife, Inc. v. Financial Stability Oversight Council*, No. 16-5086 (D.C. Cir., June 16, 2016).

56 *See* Amicus Brief of Better Markets (June 23, 2016), *available at* https://bettermarkets.com/resources/better-markets-amicus-brief-metlife-v-fsoc. Better Markets also filed an amicus brief on the merits in the district court, an unusual step but a necessary and appropriate one given the historic importance of the issues presented. *See* Amicus Brief of Better Markets in the District Court, filed May 22, 2015, *available at* https://bettermarkets.com/resources/better-markets-amicus-brief-case-metlife-v-fsoc.

bailouts and financial crashes will rise. Moreover, the proponents of cost-benefit analysis notched a significant victory, further entrenching cost-benefit analysis as a weapon against important regulations that serve the public interest.[57]

3. *Lindeen v. SEC*

The D.C. Circuit's recent opinion in *Lindeen v. Sec. & Exh. Comm'n*,[58] represents something of a mixed result with respect to the cost-benefit analysis requirements applicable to the SEC. The petitioners in that case challenged the SEC's "Reg A+" regulation establishing a new exemption from securities registration for offerings up to $50 million and preempting state registration and qualification requirements through the definition of "qualified purchaser." The court upheld the regulation, in part on economic analysis grounds. On the one hand, it embraced the 2005 holding in *Chamber* to the effect that the SEC must "determine as best it can the economic implications of the rule."[59] On the other hand, it made very clear that a relatively general qualitative consideration of costs and benefits, without any empirical data to support it, could suffice. Reciting from *NAM*, the court observed that "We do not require the Commission 'to measure the immeasurable' and we do not require it to 'conduct a rigorous, quantitative economic analysis unless the statute explicitly directs it to do so.'"[60]

D. The persistent *American Equity* problem.

A recurrent and important problem facing the SEC and other agencies in the area of cost-benefit analysis deserves special mention. An agency can unnecessarily raise the bar on itself in judicial review if it attempts more economic analysis than the law requires. In *American Equity,* the D.C. Circuit found that where an agency conducts an analysis in adopting a final rule without any suggestion that such an analysis was not required, the court will evaluate the propriety of the Commission's analysis as performed.[61] This principle continues to survive. For example, in 2012, the D.C. Circuit held that where the EPA undertook a cost-benefit analysis that was not

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[57] Fortunately, at least one other district court judge has recently read *Michigan* far more narrowly. *See Nicopure Labs, LLC v. Food & Drug Admin.*, No. 16-0878, 2017 WL 3130312 (D.D.C. July 21, 2017). In *Nicopure,* the court rejected claims that the FDA's decision to regulate e-cigarettes as tobacco products was arbitrary and capricious, in part on cost-benefit grounds. The court (1) distinguished the specific language in the Clear Air Act on which the Supreme Court relied in *Michigan*; (2) correctly read *Michigan* as conferring broad discretion on an agency when it is "considering" cost as a factor; and (3) reiterated the principle that courts must not review an agency's economic analysis de novo but must instead afford it an especially high degree of deference. *Id.* at *32-38.

[58] 825 F. 3d 646 (D.C. Cir. 2016).

[59] *Id.* at 657.

[60] *Id.* (quoting *Nat'l Ass'n of Mfrs.*, 748 F.3d at 369 (emphasis added)); *cf. Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 ("Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouse holes.").

[61] *See Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166, 168 (D.C. Cir. 2010).

required by statute, the court would nevertheless consider that analysis in reviewing the agency's rule.[62] The same principle was recognized more recently in the district court's decision in *NAM*:

> Nevertheless, insofar as the Commission considered itself subject to the requirements of Section 3(f), along with those under Section 23(a)(2), (see Def.'s Brief at 29), the Court need not conclusively decide this issue. Since the SEC conducted an analysis under Section 3(f) in adopting the Final Rule without any suggestion that such an analysis was not required, the Court evaluates the propriety of the Commission's analysis as performed, including its compliance with 15 U.S.C. § 78c(f). *Am. Equity*, 613 F.3d at 177 ("[T]he SEC must defend its analysis before the court upon the basis it employed in adopting that analysis."). However, this should not be taken as a ruling that such an analysis was actually required in connection with this particular rulemaking.[63]

This principle continues to have significant implications for federal agencies. To the extent the agency voluntarily undertakes more extensive cost-benefit analysis than the securities laws require, it unnecessarily exposes itself to a heightened risk that its rules will be invalidated for failing to meet a standard that does not actually apply.

V. <u>Executive Orders</u>

The executive branch agencies have been required to conduct cost-benefit analysis for years, pursuant to a series of executive orders that date back to the Reagan Administration.[64] These orders require executive branch agencies to quantify costs and benefits; tailor regulations to impose the least burden on society; base decisions on the best reasonably obtainable scientific, technical, economic, and other information concerning the need for, and consequences of, the intended regulation; and adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs. However, those order expressly exclude the independent regulatory agencies.

President Trump has issued a spate of executive orders and memoranda that impose draconian new anti-regulatory obligations on agencies or call for studies that will serve as the basis for the expected repeal of important regulatory protections. Some of them incorporate costs and benefits as the subject of mandated studies or as factors that must be weighed in new and particularly onerous ways. They include the following:

- Core Principles for Regulating the United States Financial System, Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017) (requiring the Treasury Secretary to review all financial regulations).

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62 *Nat'l Ass'n of Home Builders v. EPA,* 682 F.3d 1032, 1039-1040 (D.C. Cir. 2012).

63 *Nat'l Ass'n of Mfrs. v. SEC,* 956 F. Supp. 2d 43, 58 n. 15 (D.D.C. 2013).

64 *See, e.g.,* Exec. Order No. 12,866, 58 Fed. Reg. 517735 (Sept. 30, 1993); Exec. Order No. 13,563, 76 Fed. Reg. 3821 (Jan. 18, 2011).

- Enforcing the Regulatory Reform Agenda, Exec. Order No. 13,777, 82 Fed. Reg. 12285 (Feb. 24, 2017) (requiring agencies to appoint Regulatory Reform Officers and Task Forces to oversee implementation of regulatory reform initiatives).

- Executive Office of the President, Presidential Memorandum for the Secretary of the Treasury on the Orderly Liquidation Authority (Apr. 21, 2017) (requiring the Treasury Secretary to review the orderly liquidation authority).

- Executive Office of the President, Presidential Memorandum for the Secretary of the Treasury on the Financial Stability Oversight Council (Apr. 21, 2017) (requiring the Treasury Secretary to review the FSOC designation processes).

- Reducing Regulation and Controlling Regulatory Costs, Exec. Order No. 13,771, 82 Fed. Reg. 9339 (Jan. 30, 2017) (requiring the repeal of two regulations for every new regulation that is promulgated and that any cost to the industry be balanced by the repeal of other regulations, regardless of the benefits of the new or rescinded rules).

- Executive Office of the President, Presidential Memorandum for the Secretary of Labor on the Fiduciary Rule (Feb. 3, 2017) (requiring the Labor Secretary to examine the fiduciary duty rule to determine if it may adversely affect the ability of Americans to gain access to advice).

So far, however, none of those orders purport to impose cost-benefit analysis obligations on the independent agencies.

VI. <u>Academic views.</u>

Academic views on cost-benefit analysis diverge greatly and have resulted in papers both decrying and supporting the practice. Despite disagreement over whether and when cost-benefit analysis should be used, there is widespread agreement at least that cost-benefit analysis faces problems quantifying abstract social benefits. A comprehensive review of the scholarship on regulatory cost-benefit analysis is beyond the scope of this update, but a sampling of articles is warrants mention.

Professor John Coates, at Harvard, recently undertook a close examination of six rules (including the SEC's mutual fund governance reforms and cross-border swaps proposals), focusing on the details of how quantitative cost-benefit analysis requirements would work in practice if applied to these rules.[65] He concluded that cost-benefit analysis of such rules "can be no more than guesstimates," as they contain "the same contestable, assumption-sensitive macroeconomic. . . modeling used to make monetary policy, which even cost-benefit analysis advocates would exempt from cost-benefit analysis laws."[66]

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[65] John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882, 886 (2015).

[66] *Id.* at 887.

Professor Jeffrey Gordon, at Columbia Law School, argues that the system in the financial sector that generates costs and benefits "is 'constructed' by financial regulation itself and by the subsequent processes of adaptation and regulatory arbitrage."[67] He concludes that new rules change the system "beyond our calculative powers."[68] By contrast, Gordon identifies "natural" systems (e.g., the natural environment and environmental regulation) where there are certain fixed costs and benefits that do not change in response to regulation.[69] Gordon believes that instead of weighing costs and benefits, financial regulation must be designed pragmatically and grounded in analysis of the tradeoffs in normative values inherent in different regulatory approaches.[70]

Even advocates of quantitative cost-benefit analysis like Professor John Cochrane of the University of Chicago have expressed significant doubts about whether the social costs and benefits of financial regulations are ultimately susceptible to reliable and precise quantification.[71] Likewise, Richard Revesz of New York University, who promotes cost-benefit analysis as a regulatory tool, argues that regulators have not properly executed cost-benefit analysis in the past and that institutional changes at regulatory agencies would have to be made before it could be used effectively.[72] And Professor Cass Sunstein at Harvard Law acknowledged in a recent paper that "[v]alues such as dignity, equity, and fairness might be relevant, and they might prove difficult or impossible to quantify."[73]

Finally, a recent paper from Professor Robert Bartlett at the University of California at Berkeley argues that "uneven" application of formal cost-benefit analysis requirements in financial regulatory agencies demands the adoption of a "single cost-benefit analysis paradigm that requires interagency coordination and avoids judicial review."[74] According to Bartlett, such an approach would have the best chance of providing meaningful and transparent analysis of rulemaking while avoiding regulatory paralysis.

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67 Jeffrey N. Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 J. LEGAL STUD. S351 (2014).

68 *Id.*

69 *Id.*

70 *Id.*

71 John H. Cochrane, *Challenges for Cost-Benefit Analysis of Financial Regulation*, 43 J. LEGAL STUD. S63, S69 (2014).

72 Richard L. Revesz, *Cost-Benefit Analysis and the Structure of the Administrative State: The Case of Financial Services Regulation*, 34 YALE J. on Reg. 545, 548 (2017).

73 Cass R. Sunstein, *Cost-Benefit Analysis and Arbitrariness Review*, 41 HARV. ENVTL. L. REV. 1, 40 (2017).

74 Robert P. Bartlett III, *The Institutional Framework for Cost-Benefit Analysis in Financial Regulation: A Tale of Four Paradigms?*, 43 J. OF L. STUDIES S379 (2014).